administer and monitor and not so complicated that it lends itself to manipulation by the regulated entities.

In light of these principles, the time is not ripe for the Commission to allow price cap ILECs to establish a call set-up rate element.

(i). The Commission Should Neither Permit Nor Require Price Cap ILECs to Impose Call Set-Up Charges Because There is Inadequate Data to Support Such Charges, and the Costs of Imposing Such Charges Outweigh Their Economic Benefits.

Although the current per-minute local switching rate element does not separately address costs ILECs incur to provide call set-up and takedown, it appears that ILECs recover these costs through their per-minute local switching charges and perhaps through the Transport Interconnection Charge ("TIC") as well.[35] The Commission now seeks comment on allowing or requiring ILECs to impose per-call set-up charges as part of the restructuring of their local switching charges.[36]

To allow the carriers to impose such traffic-sensitive per-call charges, the Commission must find that the charges would "better reflect the way [ILECs] incur certain costs for shared local switching facilities."[37] To date, ILECs seeking

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35 *NPRM* at ¶ 75 & n.134.

36 *NPRM* at ¶ 76.

37 *NPRM* at ¶ 75.

to impose call set-up charges have not persuaded the Commission that this is the case.[38]

According to the Commission, ILECs incur call set-up costs regardless of whether or not a call is completed. Because call set-up costs are recovered through per-minute charges, the Commission has reasoned that "longer-duration calls recover a greater portion of call-setup costs than shorter calls even if they do not impose greater call-setup costs." Thus, the Commission concludes, a "per-call rate element for call-setup would more rationally reflect these costs."[39]

Whether or not this is true, important considerations argue against allowing the price cap ILECs to impose call set-up charges at this juncture.

a. The Costs of Imposing a Call Set-Up Charge Would Be Significant and Real, While the Benefits Are Merely Speculative.

The economic efficiencies that would result from imposition of call set-up charges are at most theoretical. The costs of doing so would be very tangible.

An indication of the economic efficiencies that proponents of call set-up charges can be expected to cite is provided by the unsuccessful petition of Bell Atlantic for a waiver of Part 69 of the Commission's Rules to establish a rate element for call set-up. In its petition, Bell Atlantic argued that the new rate element was justified as a matter of economics because: (1) longer calls were

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[38] *See, e.g., Bell Atlantic Telephone Companies -- Petition for Wavier of Sections 69.106 and 69.205 of the Commission's Rules to Permit a Call Setup Charge,* 4 FCC Rcd 7210 (Com. Car. Bur. 1989) ("*Bell Atlantic Petition*").

[39] *NPRM* at ¶ 75.

subsidizing shorter calls; (2) the carrier could introduce new services based on SS7 technology on a more cost causative basis; (3) it would reduce incentives for IXCs to use access "for artificial reasons in order to gain pricing advantages"; and (4) it would "promote rate structure parity between interstate access and its local exchange services."[40]

Without expressing an opinion as to the validity of these claims, the Commission rejected Bell Atlantic's request.[41] The Commission was particularly concerned that

> an abrupt change in the Local Switching element could undermine access customers' business plans which were based on a reasonable expectation of stability in the access rate structure.[[42]]

The Ad Hoc Committee shares the Commission's fear that a sudden departure from the current rate structure could create substantial churn and rate shock problems for some users. Significant segments of the national economy have priced their services based on signals that would become obsolete upon adoption of a call set-up charge. These segments pervade our economy, and include any industry that relies even in part on transaction processing via the Public Switched Telephone Network. In short, every business that accepts a credit or debit card and every bank with an automatic teller machine, just to

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40 *Bell Atlantic Petition* at ¶ 5.

41 *Bell Atlantic Petition* at ¶ 15.

42 *Id.* at ¶ 15.

name a few examples, would be adversely affected by the adoption of a per-call set-up rate element.

These industries have designed their telecommunications networks and costed out the telecommunications services on which they rely based on the assumption that their transaction processing calls will be short -- less than 30 seconds -- but numerous, and that they would pay based on the calls' duration, not number. Turning these assumptions on their heads would have an analogous effect on these industries' use of telecommunications services.

Claims of economic efficiencies, such as those Bell Atlantic has made, are, at best, unproved, and, at worst, mere speculation. The economic harms would be real. Until more reliable information substantiating claims on economic efficiencies is presented, the Commission can not decide that these benefits justify the costs that a call set-up rate element would impose. But if the Commission *does* decide to permit ILECs to impose a call set-up charge, it should gradually phase in the charge to minimize the ripple effects that the charge -- and, more broadly, the new price signals the charge would herald -- would have on the economy generally.

The Commission has long recognized the need for a transition period to implement rate increases to avoid disruption in service and the other devastating effects of rate shock. For example, in detariffing customer premises equipment ("CPE"), the Commission instituted a 24-month price predictability period for

multi-line business equipment that had previously been leased from AT&T.[43] Under the Commission's decision, AT&T was not allowed to implement full price increases for the CPE overnight; but instead was required to raise prices gradually through three transitional rate increases at eight-month intervals.[44]

Similarly, in replacing access rates based on settlement agreements with a single, cost-based rate structure, the Commission was concerned that a sudden rate shift would seriously compromise the competitive interexchange carriers' ability to provide services to many customers, thereby threatening the goal of a competitive marketplace for interstate services.[45] As a result, the Commission adopted a plan to equalize gradually the settlement rates and full special access rates.[46] Most recently, the Commission decided to allow a transition period for small, rural carriers affected by the changes in universal support mechanisms "to minimize any possible rate shock to [rural carrier] customers."[47]

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43 *Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services,* CC Dkt. No. 81-893, Second Report and Order, 98 FCC 2d 814 (1984), *affirmed,* 100 FCC 2d 1290 (1985).

44 *Id.* at ¶ 22.

45 *Investigation of Access and Divestiture Related Tariffs*, CC Dkt. No. 83-1145, Report and Order, 102 FCC 2d 1007, 1008 (1985).

46 *Id.*

47 Recommended Decision at ¶ 356.

The Commission's authority to prescribe transitional rate structures to avert rate shock has been affirmed by the courts.[48] As the Court of Appeals for the D.C. Circuit has stated, "[t]he shift from one type of nondiscriminatory rate structure to another may certainly be accomplished gradually to permit the affected carriers, subscribers and state regulators to adjust to the new pricing system, thus preserving the efficient operation of the interstate telephone network in the interim."[49]

In short, if the Commission adopts a call set-up rate element, it should phase it in gradually to avoid the effects of rate shock. In the Notice of Inquiry ("NOI") that accompanied the NPRM, the Commission stated that it required more data before making any decisions regarding the regulation of enhanced/information services providers and the applicability of the Commission's access charge and related rules to them.[50] Because of the importance of the issues, the Commission indicated a strong desire to proceed cautiously before making new policy in this area. The Ad Hoc Committee believes comparable caution is warranted here, particularly given the breadth of the impact call set-up charges would wreak on the economy. The Commission

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48 *See Western Union Telegraph Company v. FCC*, 815 F2d 1495, 1505 (D.C. Circuit 1987) (upholding the Commission's authority, in changing from settlement agreement rates to cost-based special access rates, to implement final rates for special access facilities in transition periods to mitigate the harm of rate shock).

49 *National Association of Regulatory Utility Commissioners v. FCC*, 737 F2d 1095, 1135-36 (D.C. Circuit 1984), *cert. den.*, 469 U.S. 1227 (1985) (affirming the Commission's decision to implement a transitional rate structure to recover some of the interstate share of local exchange costs through a usage sensitive charge assessed on interexchange carriers.).

50 NOI at ¶ 311.

should develop a full record with reliable data indicating the anticipated costs of a call set-up charge and credibly establishing the economic efficiencies that would result from imposition of such a charge.

Yet another reason that it is irrational to recover the cost of short-duration calls through the imposition of call set-up charges is that the vast majority of these calls are data transmissions to process or complete financial transactions. The ILECs' voice networks were not designed for data transmissions and are not optimal for them. Continuing to subsidize existing voice networks, *e.g.,* through call set-up charges, removes incentives to build data networks that would be better suited to the transmission of short data calls. The Commission should instead create incentives to build data-friendly networks, not perpetuate obsolete technologies of the past.

b. It Is Premature for the Commission to Consider Establishing a Call Set-Up Charge.

Serious churn will occur if the Commission adopts the new call set-up rate element before it determines the costs that ILECs will be permitted to recover and, then, once it has determined those costs, adjusts the charge itself to account for any difference in recoverable costs. At this time, the Commission has not determined whether price cap ILECs will be permitted to recover their fully embedded costs, only forward-looking economic costs, or some other

measure of costs. Until it resolves that question, it would be premature to establish a call set-up rate element.

Moreover, the Commission should harmonize its decision regarding call set-up charges with its action on the establishment of rate elements to recover SS7 signalling costs, which are discussed more fully below. A significant portion of call set-up charges may be attributable to Common Channel Signalling ("CCS") architecture using SS7 software. The Commission has sought comments on the establishment of new rate elements for SS7 signalling, along the lines of the waiver granted last year to Ameritech.[51] In addition, the ILECs themselves have concluded that only a portion of SS7 signalling costs is recoverable through the local switching rate element, and thus they have sought to recover a portion of the cost through the Part 69 local transport rate element.[52] The Commission should not make a determination as to the imposition of a call set-up charge should not be made until the Commission has first resolved the issue of how carriers should recover their SS7 signalling costs, and then decided what portion of carriers' call set-up costs remains unrecovered. The Ad Hoc

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[51] *See Ameritech Operating Companies -- Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled Rate Elements for SS7 Signalling,* 11 FCC Rcd 3839 (released March 27, 1996) (*"Ameritech Petition"*).

[52] *See, e.g., Southwestern Bell Telephone Company Petition for Waiver of Part 69 of the Commission's Rules, Memorandum Opinion and Order,* 6 FCC Rcd 6095 (Com. Car. Bur., 1991), *recon dismissed,* DA 92-1158 (Com. Car. Bur., rel. August 31, 1992), *applications for review pending;* Local Exchange Carrier Line Information Database, 7 FCC Rcd 525 (Com. Car. Bur.) (1991).

Committee submits that, if anything, only a *de minimis* portion of ILECs' call set-up charges would not be recovered through some other rate element.[53]

But to the extent that any call set-up costs remained after allocating costs to SS7 signalling rate elements, the Commission could not allocate the remaining costs to a new interstate call set-up rate element without first determining that recovery of those costs through that element was economically efficient in that it reflected the manner in which the carriers incurred those costs.[54] This determination could involve a reapportionment of other LEC investment and expenses among access elements through further revision to Subparts C and D of Part 69. In addition, to be certain that only that portion of residual call set-up costs that are attributable to the interstate jurisdiction are recovered through the new rate element, the Commission would have to analyze those costs under Part 36's jurisdictional separations rules. It would be premature to undertake the establishment of a new call set-up rate element without obtaining the detailed information, and without conducting the rigorous analysis that is first required.

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[53] It appears from the Commission's discussion of a proposed SS7 rate element analogous to the call set-up element that the former would recover only the costs of switching signalling data associated with a call, while the latter would apply to the costs of switching the call itself. *See NPRM* at ¶ 133.

[54] *See generally NPRM* ¶ 41 and *In the Matter of MTS and WHTS Market Structure,* 97 FCC 2d 834 (1984).

(ii). The Commission Should Neither Permit Nor Require Price Cap ILECs to Impose Different Charges During Peak and Off-Peak Periods Because Such Disparate Rates Would Be Difficult to Administer and Would Create Customer Confusion.

The Commission has noted that ILECs select the switches they will deploy in their networks based on anticipated peak demand; therefore, the Commission reasoned, ILECs "arguably should be permitted to establish separate rate elements for local switching provided during peak periods and off-peak periods."[55] The Ad Hoc Committee disagrees with this analysis. First, the fact that ILECs may select equipment based on peak demand does not logically lead to the conclusion that they should be permitted to establish separate rate elements for peak and off-peak times, rather than averaging the two.

More important, the establishment of separate rate elements for peak- and off-peak periods would be an administrative nightmare and would hurl the market into complete confusion. The Commission itself has already recognized the administrative difficulties of this proposal when it considered peak and off-peak pricing over a decade ago.[56] Among the Commission's concerns was the difficulty in determining the peak period.[57] This difficulty would not only exist as between different ILECs, but within an ILEC study area as well. For example,

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55 *NPRM* at ¶ 77.

56 *In re WATS-Related and Other Amendments of Part 69 of the Commission's Rules,* CC Dkt. No. 86-1, FCC 86-115 (released March 21, 1986) at ¶¶ 35-37.

57 *Id.* at ¶ 35.

would NYNEX's peak period in downtown Manhattan be the same as the peak period in rural upstate New York?

The Commission has provided very little basis from which to conclude that it would be more economically beneficial to establish different peak and off-peak rate elements; in the absence of such information, the difficulties of administering different peak and off-peak rate elements can not be justified.

C. Transport Interconnection Charge (¶¶ 96-122)

The *Notice* seeks comment on the appropriate mechanism for phasing out the Transport Interconnection Charge ("TIC") in a manner that fosters competition and responds to a remand by the U.S. Court of Appeals for the D.C. Circuit of the Commission Order creating the TIC.[58] The *Notice* observes that the amount currently recovered by the TIC may reflect costs in addition the economically efficient costs of transport facilities, including universal service support amounts, misallocations under the Part 36 Jurisdictional Separations rules, and historical, embedded costs that exceed the costs identified under a forward-looking TSLRIC cost standard.[59]

The *Notice* tentatively concludes that the best approach for revising the TIC is to remove readily identifiable and quantifiable cost misallocations, reassign costs to other elements when warranted by a forward-looking cost

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58 *See Notice* at notes 143 and 153.

59 *Notice* at paras. 98, 109-111.

methodology, and phase out the remainder under either of the two de-regulatory approaches discussed in Sections IV, V, and VI of the *Notice.*

The Ad Hoc Committee supports this tentative conclusion. While some "big ticket" cost items may be administratively simple to quantify, the Commission cannot simply assume the accuracy of essentially unauditable cost explanations for the all of the amounts in excess of economically efficient levels that are recovered through the TIC. The Commission's Transport restructure Orders permitted the ILECs to back out from their Transport revenue requirement the lower revenues generated by rates forced to more competitive levels,[60] since the competitive toehold for new entrants had been dedicated transport and entrance facilities, leaving behind for recovery in the TIC an amorphous collection of vestigial amounts produced by inefficient embedded cost pricing.

The *Notice* also invites parties to comment on whether the LECs should be required to write off of their regulated books of account any interstate costs included in the TIC.[61] Ad Hoc urges the Commission to give LECs the option of doing just that, as discussed in Section II.C.3, *infra.* The residual costs recovered by the TIC are a useful stalking horse for the regulatory treatment of the larger "gap" between embedded costs and TSLRIC costs discussed in the *Notice* at Sections IV, V, and VI and in Section II.C.3. of this pleading. The

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60 Transport Rate Structure and Pricing, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992); *recon.* 8 FCC Rcd 5370 (1993); *further recon.* 8 FCC Rcd 6233 (1993); *further recon.* 10 FCC Rcd 3030 (1994); *further recon.* 10 FCC Rcd 12979 (1995).

61 *Notice* at para. 120.

undifferentiated lump of residual costs recovered by the TIC is identical to the unrecoverable embedded costs revealed by competitive entry into local exchange markets which the LECs have characterized as "stranded investment." For the reasons discussed in Section II.C.3, below, the Commission's regulatory treatment of these costs should provide a competitively neutral *opportunity* for their recovery, not a guarantee of their recovery from customers and potential competitors, unless the LECs are willing to assume all of the obligations and lower returns associated with guaranteed cost recovery.

D. SS7 Signalling (¶¶ 123-138)

1. It Is Premature to Create New Rate Elements for SS7 Signalling, and the Commission Should Do So Only If It Determines that the Benefits of Such Action Outweigh the Associated Costs.

The Commission has observed that the current Part 69 rate structure may not accurately reflect the manner in which ILECs incur SS7 signalling costs, and therefore may "skew the development of competition for SS7 services."[62] Ad Hoc, however, submits that a great deal of additional information is needed to determine whether or not the current rate structure accurately reflects costs.

Under the present interim rate structure, ILECs charge IXCs and other access customers a flat-rated charge for "dedicated signalling transport," which recovers the cost of dedicated facilities connecting the customer's network and

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62 *NPRM* at ¶ 123.

the ILEC's network.[63] This rate element in turn has two subelements: a flat-rated signalling link charge for the dedicated network access line ("DNAL"), and a flat-rated signal transfer point ("STP") port termination charge.[64]

ILECs also recover the costs of querying the line information database ("LIDB") and of transmitting the query to, and answer from, the LIDB, through a per-query charge.[65] In addition, ILECs "recover costs associated with the provision of certain signalling information necessary for third-parties to offer tandem switching through the 'signaling for tandem switching' rate element."[66]

Except for the costs described above, the costs of SS7 signalling are not recovered through facility-based charges and therefore are believed to be either embedded in the TIC or recovered through the local switching charge.[67]

The Commission has asked whether it should institute a new rate structure for SS7 signalling similar (but not identical) to that for which it granted Ameritech a waiver of Part 69.[68] Following the Ameritech model, the revised rate structure would consist of the following rate elements: (1) Signal Link --

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63 47 C.F.R. § 69.125; *see NPRM* at ¶ 126.

64 *NPRM* at ¶ 126.

65 47 C.F.R. § 69.120; *see Southwestern Bell Telephone Company – Petitions for Waiver of Part 69 of the Commission's Rules,* 6 FCC Rcd 6095 (released October 4, 1991) ("*Southwestern Bell Petitions*").

66 47 C.F.R. § 69.129; *NPRM* at ¶ 126 & n.191.

67 *NPRM* at ¶ 126. To the extent that costs associated with SS7 signalling are embedded in the TIC, the Ad Hoc Committee opposes continuation of this form of cost recovery for the reasons explained in Section I.C, *supra.*

68 *NPRM* at ¶ 127; *see Ameritech Petition, supra,* note 23.

continued recovery of DNAL costs on a flat-rated basis;[69] (2) STP Port Termination – continued recovery of the cost of the STP port that connects with a customer's DNAL through a flat-rated charge, similar to today's interim rate element, but excluding charges to recover the cost of screening and switching functions of the STP, which are not performed by the port;[70] (3) Signal Transport – a new usage-sensitive charge to recover the cost of circuits that carry SS7 queries between STPs, switches, and service control points ("SCPs") within ILEC signalling networks;[71] and (4) Signal Switching – a new usage-sensitive, per-query charge, perhaps varying by peak and off-peak periods, to recover costs relating to STP processing and switching.[72]

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[69] *NPRM* at ¶ 128. The Ad Hoc Committee supports the Commission's proposal to keep the DNAL rate element in the transport service category within the trunking basket, as long as the Commission places the new STP port termination element in a different service category, as explained in note 39, *infra*. *Id.*

[70] *NPRM* at ¶ 129. The Commission also has proposed placing this rate element in a new service category in the traffic-sensitive basket, *i.e.*, in a different category than the signalling link. *NPRM* at ¶ 130. The Commission's rationale, which the Ad Hoc Committee endorses, is that the two rate elements must be in separate service categories to prevent the ILECs from subsidizing the cost of the more competitive signalling link element (which can be provided by interconnectors) with revenues from the monopoly STP port (which only the ILECs can provide). *Id.*

[71] *NPRM* at ¶ 131. The Commission has observed that the costs of signal transport appear to be related most closely to the number of queries, and therefore has asked whether the charge should be imposed on a per-query basis. In addition, it has asked whether it should allow the price cap ILECs to impose distance-sensitive charges for signal transport. *Id.* The Ad Hoc Committee agrees with the Commission's assessment that signal transport is a form of transport and therefore should be placed in the trunking basket. *Id.* at ¶ 132. As with the STP port termination rate element, however, because signal transport must be provided by the ILEC, while the signal link may be provided by other carriers, the two elements should be placed in separate service categories so that the less competitive element can not be used to subsidize the more competitive element.

[72] *NPRM* at ¶ 133. The Commission observed that the cost of signal switching appears more closely related to the number of SS7 queries than to the number or duration of calls. *Id.*

Upon closer examination, most of the Commission's proposals are neither radical nor particularly critical. Adoption of the proposed signal link rate element would be a continuation of present practice for most price cap ILECs. Similarly, the proposed STP port termination charge would be a more refined version of the port termination subelement of the dedicated signalling transport rate element authorized today. And ILECs may already recover through the LIDB query charge a portion of the costs that would be recovered through the proposed signal transport charge and the proposed signal switching rate element.

Thus, the most significant proposals the Commission has made are to authorize a usage-sensitive signal transport charge and a usage-sensitive signal switching element. The former would be somewhat akin to an extension of the LIDB query charge; the latter would be in the nature of a call set-up charge.[73]

In both cases, the movement to (or expansion of) a usage-sensitive rate element to recover costs that previously had been recovered on a non-traffic-sensitive basis would send confusing price signals to the markets for access and interexchange services and raise the same kind of rate shock and churn concerns described above. As there, the business plans of telecom customers

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Although the Ad Hoc Committee opposes the establishment of such a rate element, if the Commission nevertheless authorizes the element, the Committee agrees with the proposal to place the element in the traffic-sensitive basket. *NPRM* at ¶ 134. The Committee opposes the proposal to differentiate between peak and off-peak periods because of the difficulties the Commission has already recognized in administering and monitoring such a rate structure. *See supra* note 57 & accompanying text.

[73] *See,* however, *supra,* note 53.

with a large proportion of short-duration calls would be particularly disrupted by the sudden adoption of per-call charges where none previously existed.[74]

Moreover, as with call set-up charges, the Commission should not make any final decision on SS7 rate elements unless it has first resolved the more fundamental issue of which costs the price cap ILECs will be permitted to recover. The rate shock that would result from the sudden imposition of new per-call charges on short-duration calls would be exacerbated if the rates for these rate elements had to be adjusted to reflect a change in the scope of recoverable costs.

In addition, more work needs to be done on this issue – perhaps more than can be done in the accelerated schedule that the Commission seems to have set for this proceeding. Haste in setting an SS7 rate structure could lead to over-recovery of costs and very inefficient pricing.

For these and other reasons, the Commission should defer consideration of new SS7 rate elements to a later proceeding. At a minimum, the Commission should avoid any double counting of costs in allocating call set-up costs between SS7 rate elements and local switching rate elements.

In short, the Commission must weigh the costs of adopting the new SS7 rate elements it is considering against the economic efficiencies that are likely to flow from adoption of those elements and determine whether the benefits justify

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[74] As it did with respect to call set-up local switching charges, the Ad Hoc Committee recommends that any per-call charges that may be adopted should be phased in gradually to avoid rate shock. *See supra,* pages 20-22.

the costs.[75] In making that determination – and particularly with respect to the two proposed per-call rate elements -- the Commission should consider the following issues, among others: (1) whether long-duration calls subsidize shorter calls; (2) whether elimination of any such cross-subsidization that is found to exist would be in the public interest if implemented without a transition period; (3) whether recovery of SS7 costs through a per-call charge would be in the public interest because such a rate structure more accurately reflects the manner in which such costs are incurred; and (4) whether a rate structure such as that the Commission has proposed would be an appropriate level of unbundling of LEC SS7 networks.

To make these determinations, the Commission will need reliable data that only the ILECs can provide.[76] Without that data, the Commission would proceed blindfolded.

II. APPROACHES TO ACCESS REFORM AND DEREGULATION

Ad Hoc agrees with the Commission's long term goal of competition in the access service market. The more difficult question facing the Commission is how to get from here -- a market with little or no competition -- to there -- a market with widespread effective competition.

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[75] An evaluation of the costs of moving to the new rate structure would include a determination whether the price cap ILECs will need to install new metering equipment and, if so, the cost of such equipment. The Commission has already recognized that such equipment may impose costs that warrant its consideration. NPRM at ¶ 137.

Pending the development of competition in local exchange access markets, the Commission must protect access customers and potential competitors with a prescriptive approach based on a forward-looking, long-run incremental cost standard to replicate the prices and economic results produced by a competitive market.

The Commission cannot rely on a market-based approach to discipline pricing unless and until competition develops. As discussed in the following paragraphs, the Commission can apply a market-based approach when sufficient competition develops to create marketplace pressure on ILEC pricing but only in market segments that exhibit two characteristics: (1) the entire segment is competitive, and (2) the segment does not share significant joint costs with non-competitive segments.

A. Pending the development of competition, the Commission must use a prescriptive approach with TSLRIC prices as a transition to a market-based approach (¶¶ 218-239)

At the heart of the Commission's proposed reforms is the notion that rates for access services should be based upon forward-looking incremental or "economic" cost, rather than the historic "embedded" accounting costs underlying the present Part 69 rules. Because of the dramatic advances in telecommunications technologies during the past decade, these historic accounting costs are, for the most part, much higher

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[76] The Ad Hoc Committee thus supports the Commission's tentative conclusion that any new SS7 rate elements be treated as new services for which the price cap ILECs will be required to submit cost support data. *See* NPRM at ¶ 136.

than the forward-looking "economic" costs that an ILEC or a new entrant would incur now or in the future.

The ILECs themselves have long argued for the flexibility to set prices for access and other services that face actual competition on the basis of forward-looking incremental cost.[77] They claim that such competition is "uneconomic" if their rivals can price at forward-looking costs while the ILECs are forced to set rates at the higher, historic cost levels. At the same time, if the ILECs bring these rates down to their economic cost levels, they will collect less revenue, a condition which, they claim, will not permit them to recover their investment.[78] Thus it would seem that from the ILEC's perspective, pricing at "economic cost" requires price reductions where the ILEC faces competition, and rate increases in non-competitive markets to make up the shortfall. Under this approach, prices approaching forward-looking incremental costs might ultimately emerge in those segments of the access market in which *effective* competition is present while prices for all other services would remain at or above embedded cost levels.

The Commission's rules must ensure just and reasonable rates for customers of both competitive and non-competitive services. Once the

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[77] *See, e.g.,* Comments of USTA in CC Dkt. 94-1 Second Further Notice, December 11, 1995, at 30-31 and Attachment 1, p. 8-9.

[78] *See, e.g.,* Comments of USTA in CC Dkt. 94-1 Second Further Notice, December 11, 1995, at 30-31.

Commission concludes (as it did most recently in CC Docket 96-98[79]) that forward-looking, long-run incremental costs are the measure of reasonable rates, it must not only permit competition to drive prices to that level in competitive markets but must also ensure that its regulation of non-competitive services produces the same results for customers of those services. Therefore, the Commission must adopt a regulatory approach which reduces prices to their economic cost levels regardless of the presence or absence of actual competition.

In its *First Interconnection Order* issued last summer in CC Docket 96-98 and once again in this *Access Charge Reform* NPRM, the Commission recognizes that forward-looking, long-run incremental cost ("LRIC") is the appropriate measure of economic cost. The Commission adopted the TELRIC pricing requirement for unbundled network elements in the *First Interconnection Order* in order to simulate in noncompetitive market segments the pricing conditions that would prevail were effective competition to arise in those areas,[80] which is precisely why the "prescriptive" approach to access charge pricing proposed in this NPRM for noncompetitive ILEC access services must be adopted.

The Commission must prescribe TSLRIC-based rate levels for the access elements because most switched access services do not confront

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79 First Interconnection Order at ¶ 620.

80 *Id.*

effective competition at this time. The lack of competition to constrain ILEC prices for switched access services is evidenced by the fact that the ILECs charge price levels well in excess of TSLRIC. In competitive markets, prices move towards forward-looking incremental costs; the more competitive the market, the closer to unity is that price/incremental cost relationship. The reason for this result is straightforward enough: if prices in the market are in excess of forward-looking incremental cost, a competitor could enter the market, incur those cost levels, and offer its products or services at prices that fall below those of the incumbents, forcing the latter to reduce their prices as well. This process would continue until the price levels roughly approximate forward-looking costs, at which point further entry would not be profitable. Conversely, if prices are set below forward-looking incremental cost, incumbents will lose money (in the long run[81]) and be forced to exit the market, thereby reducing the aggregate market supply and causing market prices to rise. Long run equilibrium, in this model, arises at the point where price levels roughly match incremental costs. Thus, the proposal in the *Notice* — to require TSLRIC price levels for monopoly access services where competition is not present — would properly replicate the results of competitive markets.

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[81] If market conditions require that certain prices be set below long run incremental cost but in excess of *short run incremental cost*, the firm is still better off selling at these price levels rather than foregoing sales altogether. If all prices are, on average, set below long run incremental cost, however, the firm will ultimately be forced out of business.

Achieving an equilibrium of price levels at incremental costs requires that market entry and exit be relatively easy and that incumbents confront relatively insignificant levels of sunk costs. Where entry is restricted (for whatever reason[82]), price levels well in excess of forward-looking costs can be sustained; where incumbents confront significant amounts of "sunk" costs — costs that will not be avoided if the firm exits the market or foregoes sales in the short run — price levels *below* long run incremental cost, at least in some market segments, become possible, at least for a time, although entry would be unlikely to occur under such circumstances.

Economists and policy makers have long recognized that the local exchange telephone service market is characterized both by major entry barriers and by extensive sunk costs. The presence of such conditions make it possible for above-cost price levels to be sustained over an extended period of time (but presumably short of the theoretical "long run"), while the presence of significant amounts of sunk investment make it possible for ILECs to selectively target specific services at price levels below long run incremental cost if, for example, such an initiative is required to discourage entry.

Such targeting is further facilitated by the extensive base of resources that are shared among a number of individual services, only

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[82] Entry may be restricted due to the refusal of an incumbent to deal, to legal or regulatory impediments or even outright bars, or to fundamental economic conditions in a particular

some of which may confront actual competition. For example, an ILEC might confront competition for its special access services in an urban business center, but may face little or no *switched access* competition in that same area. Both of these services, however, will typically utilize many of the same resources, such as interoffice transport facilities, subscriber loop cables, and associated supporting structures. Whether computed on an embedded or an incremental cost basis, the shared costs of such jointly-used assets must be recovered from all of the individual services that they support.

Multiproduct incumbent firms like the ILECs have the ability to discourage or prevent entry by others or force their withdrawal from the market if the incumbent confronts varying degrees of competition in its individual product/service markets. Differing levels of competition enable an incumbent to set prices in competitive markets below long run incremental cost (but in excess of short-run marginal cost). A regulated multiproduct firm can finance such a tactic by increasing prices in noncompetitive segments so as to absorb the foregone revenues in the competitive segment, while still remaining at or under the overall aggregate earnings constraint. The Commission can discourage this tactic by excluding the competitive segments altogether from the calculation of aggregate regulated revenue. However, unless "monopoly" and "competitive" market

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product/service market in which *de novo* entry requires substantial amounts of capital, extended

segments are correctly defined and fully separated, the potential for such flows to occur continues to exist.

Thus, to the extent that services that become subject to market-based pricing utilize plant in common with noncompetitive "prescriptive priced" services, the Commission must, as a threshold matter, address and deal with the manner in which shared costs are divided between these two groups and among those services for which prescriptive pricing will continue to apply in a manner which ensures that non-competitive services don't receive a disproportionate share of costs.

B. Design and implementation of a prescriptive approach (¶¶. 218-239)

As discussed above, the Ad Hoc Committee agrees with the *Notice* that "a prescriptive approach would move access rates to forward-looking economic costs in a more predictable and uniform manner than a market-based approach"[83] and believes that the advantages of such an approach greatly outweigh the disadvantage of "requir[ing] that the Commission play a greater role in the telecommunications marketplace."[84] Ad Hoc likewise supports the Commission's stated "intermediate" goal for prescriptive

periods of time, or both

83 *NPRM* at ¶218.

84 *Id.*